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Department of the Treasury
Washington, DC 20224

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Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

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Date:
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RE:

Legend

Grantor =
Trust =

Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
Date 7 =
Date 8 =
Date 9 =
Date 10 =
Date 11 =
Date 12 =
Child 1 =
Child 2 =
Grandchild 1 =
Grandchild 2 =
Grandchild 3 =
Grandchild 4 =
Grandchild 5 =
Grandchild 6 =
Trustees =
Corporation 1 =

Corporation 2 =
Library =
Court =
State =
X =
Y =
Year 1 =
Year 2 =

Dear :

This letter responds to your authorized representative's letter dated June 18, 2013, requesting rulings on the estate, gift, generation-skipping transfer (GST), and income tax consequences of the proposed severance of a trust pursuant to a settlement agreement.

The facts and representations submitted are summarized as follows:

On Date 1, a date prior to September 25, 1985, Grantor established an inter vivos irrevocable trust (Trust) for the benefit of Grantor's grandchildren, Grandchild 1, Grandchild 2, Grandchild 3, Grandchild 4, Grandchild 5, Grandchild 6, and their descendants (Beneficiaries). It is represented that Child 1 and Child 2 have been trustees (Trustees) of Trust since Trust's inception. Child 2 resigned as co-trustee on Date 9, leaving Child 1 as sole trustee of Trust.

Trust was funded with stock of Corporation 1 and Corporation 2. Trust owns X percent of the outstanding stock of each of Corporation 1 and Corporation 2. Grandchild 3 and Grandchild 4 each own Y percent of the outstanding stock of each of Corporation 1 and Corporation 2. The primary asset of each corporation is farmland and each corporation's primary business activity is farming. On Date 12, Grandchild 3's 30th birthday, Trust is obligated to distribute an additional Y percent of outstanding shares in each Corporation 1 and Corporation 2 to Grandchild 3.

The terms of Trust are as follows:

Article II, Paragraph 1 of Trust provides that Trustees will accumulate income for twenty-one years after the date Trust was created and add the accumulated income to principal.

Article II, paragraph 2, provides that beginning twenty-one years after the date Trust was created all income will be distributed by Trustees in convenient installments, at least annually, to the living descendants of the children of Grantor, *per stirpes*. If any descendant receives any distribution of principal, his share of income and that of his descendants will be proportionately reduced from time to time.

Article II, paragraph 3, provides that when any descendant of a child of Grantor reaches the age of twenty-five, Trustees will distribute to him one-third of the share of principal of Trust from which he is receiving income. When he reaches the age of thirty, Trustees are to distribute to him one-half of the share of principal of Trust from which he is receiving income. When a beneficiary reaches age thirty-five, Trustees are to distribute to him all of the principal of Trust from which he is receiving income.

Article II, paragraph 4, provides that each descendant of a child of Grantor is given a limited power of appointment to appoint and direct by Will specifically referring to this power of appointment. Each descendant of a child of Grantor may appoint one-half of the income, to be distributed at least annually, from the proportion of the principal of Trust from which such descendant was entitled to receive income at his death, to his surviving spouse until the surviving spouse has remarried or died.

Article II, paragraph 5, provides that while either or both of Child 1 or Child 2 are living, if, after twenty-one years after the date of the execution of Trust, or while any time thereafter, no descendant or child of Grantor is then living, all income will be distributed by Trustees, at least annually to Library, less any amounts of income then distributable to a surviving spouse of a deceased descendant of a child of Grantor.

Article II, paragraph 6, provides that if twenty-one years after the date of execution of Trust, or any time thereafter before the termination of Trust, both children of Grantor are deceased and there are no descendants or a child of Grantor living, Trust will terminate and all principal and undistributed income will be distributed to Library. Trustees will withhold from distribution any portion of Trust from which a spouse of a deceased descendant of a child of Grantor is entitled to receive income until spouse is no longer entitled to receive the income.

From Year 1 through Year 2, Trust, Trustees, and Beneficiaries were involved in litigation in Court. Some Beneficiaries made claims against Trustees for breach of fiduciary duty and Trustees made claims against each other. Some of the Beneficiaries desired to have separate trustees and pursue different investment strategies for their respective shares of the assets held in Trust. All Beneficiaries, except Grandchild 5 and Grandchild 6 desired that Trust sell the stock in Corporation 1 and Corporation 2 and invest the proceeds in other assets. Grandchild 5 and Grandchild 6 desired to retain their collective interest (through Trust) in the shares of both corporations. Child 1 desired to that either he and/or trusts for Grandchild 5 and Grandchild 6 and other designees of Child 1 purchase the stock in Corporation 1 and Corporation 2, in order to keep the farmland in the family.

Trust was formed prior to September 25, 1985 and has never been amended. It is represented that there have been no additions to Trust on or after September 25, 1985. Therefore, Trust is currently exempt from the generation-skipping transfer tax pursuant to § 1433(b)(2)(A) of the Tax Reform Act of 1986.

On Date 2, Court construed the terms of Trust as providing a multiple generation class gift and concluded that the children, not the grandchildren, were the root generation of Trust. The Court concluded that Grantor intended for Child 1's descendants to receive one-half of Trust principal and income and for Child 2's descendants to receive one-half of Trust income and principal, regardless of how many children were born to each child.

On Date 4, Court clarified and modified the Date 2 order, in part, as follows:

The class of beneficiaries under Trust does not close until Trust terminates. Until such termination, the class of beneficiaries may be increased or decreased by birth adoption or death.

Paragraph 1 of Trust provides income is to be accumulated for twenty-one years and paragraph 3 provides that principal distributions are to begin when the oldest beneficiary attains the age of 25. Grandchild 3, the oldest beneficiary, attained the age of twenty-five on Date 3. As of this date, Grandchild 3 is a beneficiary as to one-fourth of Trust.

As of this date, Grandchild 3 and Grandchild 4 are each entitled to receive one-fourth of the accumulated income, if any, as provided in paragraph 2 of Trust.

As of this date, Grandchild 1, Grandchild 2, Grandchild 5, and Grandchild 6 are each entitled to receive one-eighth of the accumulated income, if any, as provided in paragraph 2 of Trust.

Now that Grandchild 3 has attained the age of twenty-five, his interest in one-twelfth of the principal of Trust has vested and he is entitled to receive one-third of his one-fourth (or one-twelfth) of the principal of Trust as this time.

On Date 5, Child 1, Grandchild 1, and Grandchild 2 entered into a mutual release and settlement agreement with respect to the litigation and certain other matters. The agreement was approved by Court. On Date 6, a guardian (Guardian) was appointed by Court as Guardian ad Litem for minors, Grandchild 5 and Grandchild 6, to represent them in the settlement and related matters in litigation.

On Date 7, Trust, Trustees, and Beneficiaries entered into a comprehensive settlement agreement (Settlement Agreement) which was approved by Court on Date 8.

On Date 10, Trust, Trustees, and Beneficiaries entered into a first amendment to Settlement Agreement which was approved by Court on Date 11. The amendment

replaced the original Severance Agreement in Settlement Agreement in its entirety with a new Severance Agreement.

The terms of Severance Agreement are as follows:

Trust is to be divided into four separate trusts: Trust 1 for the benefit of Grandchild 1 and Grandchild 2; Trust 2 for the benefit of Grandchild 5 and Grandchild 6; Trust 3 for the benefit of Grandchild 3, and Trust 4 for the benefit of Grandchild 5 (Severed Trusts). In funding the Severed Trusts, all of the assets of Trust are to be allocated and distributed to the Severed Trusts on a pro-rata basis. Trust 1 and Trust 2 are referred to as the Child 1 Severed Trusts. Trust 3 and Trust 4 are referred to as the Child 2 Severed Trusts.

Each severed trust is to be treated as a separate trust for all purposes, and will be governed by and administered in accordance with the terms of Trust as if Beneficiaries under each Severed Trust were the only descendants of Child 1 and Child 2, respectively.

Each Severed Trust will have different trustees.

If Child 1 or Child 2 has additional children, each additional child will be included as beneficiaries of the Child 1 or Child 2 Severed Trusts, respectively. If any beneficiary of a Severed Trust dies, the properties held in trust will be reallocated among the Severed Trusts and Beneficiaries in a manner that would have occurred under Trust absent the Severance Agreement.

You have requested the following rulings:

1. After the proposed division, the Severed Trusts will continue to be exempt from the GST tax.
2. The proposed division of Trust will not cause any beneficiary to have made a taxable gift.
3. The proposed division of Trust will not cause any portion of the assets of the Severed Trusts to be includible in the gross estate of any beneficiary as of the time of such division.

4. The pro-rata allocation of assets and liabilities of Trust in approximately equal shares will not cause Trust, the Severed Trusts, or any beneficiary to recognize any ordinary income or loss or capital gain or loss.

5. The adjusted basis of the assets received by the Severed Trusts will be the same as the respective adjusted basis of the assets held by trust pursuant to § 1015.

6. The holding periods of the assets received by the Severed Trusts will be the same as the holding periods of the assets in Trust pursuant to § 1223(2).

Ruling #1

Section 2601 of the Internal Revenue Code imposes a tax on every generation-skipping transfer made after October 22, 1986.

Section 2611(a) provides that the term “generation-skipping transfer” means a tax distribution, a taxable termination, and a direct skip.

Under § 1433 of the Tax Reform Act of 1986 (the Act), the GST tax is generally applicable to generation-skipping transfers made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i) of the Generation-Skipping Transfer Tax Regulations, the tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, except to the extent the transfer is made out of corpus added to the trust by an actual or constructive addition after September 25, 1985.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under § 26.2601-1(b) will not cause the trust to lose its exempt status. These rules are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. The rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(B) provides that a court-approved settlement of a bona fide issue regarding the administration of the trust or the construction of terms of the governing instrument will not cause an exempt trust to be subject to the provisions of chapter 13, if -- (1) the settlement is the product of arm's length negotiations; and (2) the settlement is within the range of reasonable outcomes under the governing instrument and applicable state law addressing the issues resolved by the settlement. A settlement that results in a compromise between the positions of the litigating parties and reflects the parties' assessments of the relative strengths of their positions is a settlement that is within the range of reasonable outcomes.

Section 26.2601-1(b)(4)(i)(D) provides that a modification will not cause an exempt trust to be subject to the GST tax if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. A modification of an exempt trust will result in a shift in a beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a generation-skipping transfer or the creation of a new generation-skipping transfer. Furthermore, a modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered a shift in a beneficial interest in a trust.

Section 26.2601-1(b)(4)(i)(E), Example 5, considers a situation in which, in 1980, Grantor established an irrevocable trust for the benefit of his two children, A and B, and their issue. Under the terms of the trust, the trustee has the discretion to distribute income and principal to A, B, and their issue in such amounts as the trustee deems appropriate. On the death of the last to die of A and B, the trust principal is to be distributed to the living issue of A and B, per stirpes. In 2002, the appropriate State Court approved the division of the trust into two equal trusts, one for the benefit of A and A's issue and one for the benefit of B and B's issue. The trust for A and A's issue provides that the trustee has the discretion to distribute trust income and principal to A and A's issue in such amounts as the trustee deems appropriate. On A's death, the trust principal is to be distributed equally to A's issue, per stirpes. If A dies with no living descendants, the principal will be added to the trust for B and B's issue. The trust for B and B's issue is identical (except for the beneficiaries), and terminates at B's death at which time the trust principal is to be distributed equally to B's issue, per stirpes. If B dies with no living descendants, principal will be added to the trust for A and A's issue. The division of the trust into two trusts does not shift any beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the division. In addition, the division does not extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust. Therefore, the two partitioned trusts resulting from the division will not be subject to the provisions of chapter 13.

In the present case, based upon the facts submitted and the representations made, we conclude that Trust is exempt from GST tax because Trust was irrevocable prior to September 25, 1985 and it is represented that there have been no additions to Trust on or after September 25, 1985.

In addition, the facts provided and representations made indicate that the proposed severance set forth in Severance Agreement represent a compromise between the positions of the litigating parties and reflect the parties' assessments of the relative

strengths of their positions. These facts and representations indicate that the settlement is the product of arm's length negotiations and is within the range of reasonable outcomes under Trust's terms and applicable State law.

Accordingly, based upon the facts submitted and the representations made, we conclude that after the proposed division of Trust pursuant to the Severance Agreement, the Severed Trusts will continue to be exempt for purposes of the GST tax.

Ruling #2

Section 2501(a) imposes a tax on the transfer of property by gift during the calendar year by any individual.

Section 2511 provides that the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

In this case, the proposed severance of Trust pursuant to Severance Agreement does not increase, decrease, or otherwise change any Beneficiary's beneficial interest in Trust. Accordingly, based upon the facts submitted and the representations made, we conclude that the proposed division of Trust into Severed Trusts will not cause any Beneficiary to have made a taxable gift.

Ruling #3

Section 2035(a) provides that if (1) the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and (2) the value of such property (or an interest therein) would have been included in the decedent's gross estate under § 2036, 2037, 2038, or 2042 if such transferred interest or relinquished power had been retained by the decedent on the date of the decedent's death, the value of the gross estate shall include the value of any property (or interest therein) that would have been so included.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death -- (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2037 provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time after September 7, 1916, made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if (1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and (2) the decedent has retained a reversionary interest in the property, and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or in conjunction with any other person (without regard to when or from what source the decedent acquired such power) to alter, amend, revoke, or terminate, or where any such power is relinquished during the 3-year period ending on the date of the decedent's death.

In this case, the Beneficiaries of Trust are not the transferors of Trust property for purposes of §§ 2036, 2037, and 2038. The proposed severance of Trust pursuant to Severance Agreement do not increase, decrease, or otherwise change any beneficiary's beneficial interest in Trust. Accordingly, based upon the facts submitted and the representations made, the division of Trust into Severed Trusts, and the other proposed modifications to Trust set forth in Severance Agreement will not cause any assets of Trust or the Severed Trusts, to be included in the gross estate of any beneficiary of Trust or the Severed Trusts.

Ruling #4

Section 61(a)(3) provides that gross income includes gain derived from dealings in property.

Section 1001(a) provides that the gain realized from the sale or other disposition of property is the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss realized is the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized. Under § 1001(c), the entire amount of gain or loss realized must be recognized, except as otherwise provided.

Section 1.1001-1(a) of the Income Tax Regulations provides that, except as otherwise provided in subtitle A, the gain or loss realized from the exchange of property for cash or for other property differing materially either in kind or in extent is treated as income or loss sustained.

Rev. Rul. 56-437, 1956-2 C.B. 507, holds that the conversion of a joint tenancy in stock to a tenancy in common in order to eliminate the survivorship feature, and the partition of a joint tenancy in stock, are not sales or exchanges and, therefore, do not result in the realization of gain or loss.

In this case, after the proposed transfer the beneficiaries will have substantially the same beneficial interest in the assets of the Severed Trusts that they had in the assets when those assets were held by the original Trust. Accordingly, based on the facts submitted and the representations made, we conclude that the pro rata allocation of assets and liabilities of Trust in fractional shares is not a sale or exchange and, therefore, will not result in the realization of gain or loss under § 1001 to Trust, the Severed Trusts, or any of the trust beneficiaries.

Rulings #5 and #6

Section 1015(b) provides that the basis in property acquired by a transfer in trust is the same as it would be in the hands of the grantor, with adjustments for gain and loss recognized.

Section 1.1015-2(a)(1) provides that in the case of property acquired after December 31, 1920, by a transfer in trust (other than a transfer in trust by gift, bequest or devise) the basis of property so acquired is the same as it would be in the hands of the grantor increased by the amount of gain or decreased in the amount of loss recognized to the grantor upon such transfer under the law applicable to the year in which the transfer was made.

Section 1.1015-2(a)(2) applies the uniform basis principles in § 1.1015-1(b) for determining the basis of property where more than one person acquires an interest in property by transfer in trust.

Under § 1.1015-1(b), property acquired by gift has a single or uniform basis although more than one person may acquire an interest in the property. The uniform basis of the property remains fixed subject to proper adjustment for items under §§ 1016 and 1017.

Section 1223(2) provides that in determining the period for which the taxpayer has held property, however acquired, there shall be included the period for which such property was held by any other person, if under Chapter 1 of the Code such property has, for the purpose of determining gain or loss from a sale or exchange, the same basis in whole or in part in the taxpayer's hands as it would have in the hands of such other person.

In this case, § 1001 does not apply to the proposed transaction. Thus, after the division of Trust and transfer of the assets into the Severed Trusts, the adjusted basis of the assets received by the Severed Trusts will be the same as the respective adjusted

basis of the assets held by Trust pursuant to § 1015. Furthermore, we conclude that, under § 1223(2), the holding periods of the assets received by the Severed Trusts will be the same as the holding periods of the assets in Trust.

In accordance with the Power of Attorney on file with this office, we have sent a copy of this letter to your authorized representatives.

Except as expressly provided herein, we neither express nor imply any opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the Taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Lorraine E. Gardner
Senior Counsel, Branch 4
Office of the Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures

Copy for § 6110 purposes
Copy of this letter

cc: